**ECON Hearing on the Covid-19 Outbreak**
***15th June 2020***
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Thank you for inviting me to speak at this hearing.

The Covid-19 outbreak was in the first instance a healthcare problem. However, when suppression of the virus turned out to be impossible, immediately very serious knock on economic effects followed. In order to mitigate the pressure on the healthcare sector, economic restrictions were imposed across the EU, including lockdowns in several shapes and forms. The virus outbreak thus caused a symmetric very large negative supply shock across countries also hampering the functioning of the Single Market. At the same time it was an asymmetric supply shock within countries.

There seems to be wide consensus on the required economic policy response during the phase of getting the outbreak under control taking into account the absence of a vaccine and/or medicine. This policy consists of providing income and liquidity support and bridge finance to households and firms with government guarantees. To support these policies the excessive public debt rules, some EU competition rules and bank capital requirements were helpfully relaxed or are being applied with maximum flexibility. Nevertheless, economic policies will not prevent the occurrence of a deep recession. But they can cushion the impact of the shock and limit the damage done.

We have now entered the phase that countries are gradually and cautiously exiting lockdowns. It must be noted that this happens at a moment that the virus has not been eliminated. A scenario with one or more future lockdown periods cannot be ruled out nor ignored. Therefore, economies have not yet entered the recovery phase. That phase will only start at the moment that a new lockdown can be ruled out with high confidence, i.e. in a plausible worst case scenario. Or in other words when the Coronavirus can be judged to be under control. Implementing recovery policies now runs the risk of them being ineffective, because of being premature.

At the moment we are entering the next phase of getting the virus under control, still a crisis phase. Preventing new lockdowns should be the prime objective of policies at the current juncture. This can only be combined with opening up the economy and restoring the Single Market, if countries will aim at containing the virus through coordinated intensive test, trace and quarantine policies.

Currently households, corporates, banks and governments in particular are using buffers and borrowing. Governments should take all necessary measures to get the virus under control, limit and cushion economic fall out. But no more than that. Budgetary discipline for the "non Corona" part of the budget should be maintained. Already before the outbreak of the Coronacrisis in at least some cases government debt levels were problematic. The outbreak of the coronavirus has worsened that situation and added more countries to the list of countries with a problematic government debt level. And it will continue to do so for the time being.

As a consequence the ECB is in a delicate position. Government debts in several countries and the euro itself are only sustainable at very low interest rates. The ECB is forced to act as a yield curve targeter at very low levels. It is locked into a debt dominance policy regime. This may impair the ECB in fulfilling its mandate and has therefore potentially serious consequences for inflation, financial stability, growth and the sustainability of the euro itself.

Therefore, policy priority at the start of the recovery phase should be to address the issue of restoring buffers and reducing debt levels of households, firms, banks and governments. Policies that at that time focus primarily on stimulating aggregate demand and growth will likely be ineffective if high debt levels are not addressed at the same time or before. Moreover, they would not take away concerns about the sustainability of government debts and the euro and the room for manoeuvre of the ECB.

Thank you for your attention!